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Northern Trust

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March 15, 2006

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551
regs.comments@federalreserve.gov
Docket Number OP-1257

RE: Response to Request for Comment – Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy

Ladies and Gentlemen:

Northern Trust Corporation appreciates the opportunity to comment on the Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy (“Consultation Paper”) as released on June 15, 2006.

Northern Trust Corporation (“Northern Trust”) is a multi-bank holding company with its headquarters in Chicago, Illinois. The corporation has a network of offices in 18 U.S. states, international offices in seven countries and approximately 9,000 employees worldwide. Northern Trust conducts its global activities through The Northern Trust Company, an Illinois-chartered bank (the “Bank”), one national bank, a federal thrift institution, an Edge Act subsidiary, and a number of non-bank subsidiaries. Northern Trust had balance sheet assets totaling over \$60 billion as of December 31, 2006.

Northern Trust engages as one of its principal lines of business in the custody and management of assets, holding under custody assets totaling in excess of \$3.5 trillion as of December 31, 2006. Of these assets in excess of \$1.7 trillion are global custody assets held through a network of Northern Trust affiliates and subcustodians located throughout the world.

The global custody business and other activities of Northern Trust result in securities trading and related transactions all over the world, covering many jurisdictions and time zones and utilizing numerous settlement and payment systems. Consequently Northern Trust initiates and receives numerous payments every day, some of which may be very large. In the US, on an



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average business day, Northern Trust's affiliates (including the Bank and our Edge Act corporation) might send and receive payments with a USD value upwards of \$145 billion. On some days the value of payments may be considerably in excess of this amount.

Accordingly, Northern Trust is highly focused on intraday liquidity issues. We have given careful consideration to the questions posed in the Consultation Paper and are pleased to respond as follows:

1. What intraday liquidity conservation strategies and technologies does your institution use (such as controlling the timing of payments and introducing queuing techniques to conserve on liquidity)? How do these affect your institution's timing for sending payments? What, if any, changes are you planning with regard to intraday liquidity management?

The Bank currently uses both queuing and throttling (i.e. holding outbound wires) techniques to conserve intraday liquidity. Throttling techniques involve holding large dollar outbound wires or holding all outbound wires when the Bank's reserve account balance reaches predetermined overdraft levels. The Bank also employs techniques that control daylight overdrafts within client accounts. Our practice with respect to Fed Funds is to employ a queuing technique that automatically returns borrowed funds 23 hours after receipt of funds the prior day.

The Bank will continue to make use of the techniques discussed above, but under pressure to remain within established debit caps might reduce the review and hold "threshold" for individual outbound wires.

2. How do the concentrated demands for intraday central bank money by private sector systems influence intraday liquidity management by depository institutions throughout the day? Are there significant concentrated sources of demand for intraday central bank money beyond those already mentioned in the text and how does this demand affect intraday liquidity management?

It is generally against the rules of private sector systems to withhold payments. In the case of securities trades, e.g. Depository Trust Company eligible securities such as equities, settlement is a matter of convenience and usually occurs three days after trade date. From the point of view of a custodian, this situation can create conflict. The velocity of financial movements through custodial accounts including client cash management activities and same day trading can make funding of payments a complex task. A bank's obligation to settle the agreed trade might conflict with prudent Payment System Risk practices.



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The Depository Trust Company requires progress payments when participants are short or beyond their credit limits. DTC does not, however, make progress payments to participants when the balance of payments is in the opposite direction. These practices contribute to pressure on banks' Federal Reserve Bank caps. A CHIPS settlement arrangement would be far superior in this respect. Under current practices, DTC is indirectly utilizing their participants' caps.

Other demands for intraday liquidity include the settlement of private equity investments, derivatives, mutual funds, cross-market trades, and other large non-DVP settlements.

3. Is the concentration of payments late in the day a concern for your organization? If so, what is the nature of your concern? Does it include operational risk from late-in-the-day payments, and has operational risk to your organization from such payments been increasing or decreasing? What are the key drivers of late-in-the-day payments? How has your organization responded to the late-in-the-day concentration of payments?

Yes, Northern Trust is seeing a gradual shift of payments (both paid and received) to later in the day. Systemic problems occurring late in the day could result in increased liquidity risk as the banks may have to cover failed incoming payments. The result is also increased risk to clients and counterparties. Select but credit-worthy clients served in a custodial context require the timely settlement of trades and minimal interruption to payment flows but may be concentrating cash elsewhere, leaving no cash "cushion" to cover for expected late-day payments which may not arrive on time. These and other situations add stress to payment flow particularly when client investments cross payment systems, i.e. when purchases of US Treasuries are funded by a sale of domestic or foreign equities possibly involving a foreign exchange transaction.

4. For the market, operational, and PSR Policy changes discussed in this document and listed as follows, how might the timing of payments and the demand for daylight overdrafts be affected? What advantages or disadvantages do you see for these changes?
 - An intraday market to exchange liquidity between institutions that hold positive balances at the Reserve Banks and those that run negative balances

Northern Trust believes that systems limitations and pricing constraints will prevent this from happening.

- A market for the early return of federal funds or other money market investments

Northern Trust believes that this self-policing market already exists. However, system limitations require the next-day returns be handled manually.



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- Enhancements by private settlement systems that further economize on the use of central bank money, for example multiple settlement periods to release liquidity earlier in the day

Multiple settlement periods or CHIPS-like settlement mechanisms would be preferable to one-way progress payments and single net settlements.

- Liquidity saving mechanisms for the Fedwire funds transfer system

A CHIPS-like settlement mechanism would allow a minimal amount of liquidity to support payment settlements. This arrangement would increase efficiency while limiting credit risk.

- Throughput requirements for the Fedwire funds transfer system

Northern Trust cannot envisage how throughput requirements would work given the amount of same-day activity that occurs.

- Greater use of voluntary or required collateral to cover partially or fully daylight overdrafts in depository institution accounts at the Reserve Banks

Northern Trust would support greater use of voluntary collateral to cover credit risk associated with daylight overdrafts beyond the net debit caps determined by the self-assessment process. Northern Trust believes that the process whereby net debit caps may be increased by means of collateralization should be made more open, transparent and regular. We understand the need for confidentiality as to certain aspects of cap increases obtained through collateralization but we believe that in the interests of maintaining a level playing field among institutions and Districts the standards and process for obtaining net debit cap increases through collateralization should be public. For example Northern Trust believes that the In-transit Collateral Program (known to be offered to certain banks in the Second District and believed to be offered to custodial banks in the First and Fourth Districts) should be available under common standards to all institutions.

Northern Trust also believes that any collateral held at the discount window should be available and acceptable to use on an intraday basis.

- Two-tiered pricing for collateralized daylight overdrafts, with a fee charged for collateralized daylight overdrafts set lower than the rate for uncollateralized overdrafts



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Northern Trust does not believe that fees have made much of a difference in cap usage. Maintaining daylight overdrafts within established net debit caps is a higher priority than reducing daylight overdraft costs. However, any discussion of a modified fee structure should be coupled with standardization a full disclosure of the collateral programs available.

- Time-of-day pricing of daylight overdrafts

Northern Trust does not believe that time of day pricing will have a material impact on the management of daylight overdrafts.

Northern Trust Corporation appreciates the opportunity to comment on the Consultation Paper and we hope that these comments will be useful to the Board of Governors in their ongoing consideration of payment system risk and intraday bank liquidity issues.

Respectfully submitted,

William R. Dodds, Jr.
Senior Vice President
Treasurer

WRD:az